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Political Barriers and the Transmission of Monetary Policy Across States: The New England Antebellum Banking Market

Andrew J. Economopoulos
Ursinus College, aeconomopoulos@ursinus.edu

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Andrew Economopoulos
Ursinus College

ABSTRACT

The New England antebellum banking market was examined to understand the interaction of political ideology and economic forces. With each state controlling bank entry, hence the money supply, political ideology could impede the supply of money within a state. However, the monetary forces from neighboring states may have influenced the degree to which parties held true to their political ideology. The results indicate that political ideology was an effective barrier in two of the six states, while three states were responsive to neighbor states' monetary policy regardless of political ideology. These states responded by creating new banks, raising existing capital levels, or doing both.

INTRODUCTION

The antebellum banking was a unique period of banking history where each individual state not only determined its own bank regulatory structure, but also determined the nature, level, and growth of its own money supply. In some states, banks received the privilege of incorporation, authorization to issue bank notes, operated under a general banking code, and entered freely into the market as needed. In other states, legislatures would issue specialized corporate charters that authorized banks to issue bank notes, but would determine who and how many banks could enter the market. While other states strictly prohibited bank incorporation and note issue.[1] The wide range of regulatory structures can be traced, in part, to the cultural forces of business enterprises and political ideology of the majority party in office. As Bray Hammond (1957) noted

> "...the monetary funds that the banks provided were commonly in the form of their own circulating notes, handed over the counter to the borrower, and the expansion of the circulating medium was the palpable and visible aspect of the expansion of credit. Everyone recognized that the more banks lent, the more there was. That is why they {banks} were a political issue. That is why they were denounced by Thomas Jefferson ... and... why most Americans esteemed them." (viii-ix)

Although the political ideology of the majority party shaped the regulatory structure, most analysis of the antebellum banking market has assumed that the political institutional structure was external to the market outcome. Little has been done empirically

to examine how economic forces may have shaped the antebellum political process or how the political process may have impacted the antebellum economic outcome.[2] The purpose of this paper is twofold: first, did economic forces external to a state influence the banking policy of that state; and second, did the political nature within a state impede the economic process.

To test these hypotheses, we examine the New England antebellum banking market for two reasons.[3] First, New England was the only region-wide banking market where bank notes circulated at par (face) value. Since the system allowed bank notes to travel and circulate among the states at par, the entry/monetary policy of one state could potentially impact the banking market and policies of a neighboring state. Second, the New England states had a wide variety of regulatory structures and political ideologies. Three states maintained dual-banking systems where banks could enter either by receiving a legislative charter or enter under a free banking law. The remaining three states maintained the exclusive legislative approval process; two states held strong legislative oversight while the other appeared to be de facto free banking.

This study will proceed as follows. In Section II an overview of the political ideology of each party and of each state is presented. In Section III, the theoretical model of competitive bank entry is given. The evidence and concluding remarks are presented in Section IV.

POLITICAL IDEOLOGY AND BANK ENTRY

Two major political parties controlled the governor's office in New England between 1836-1855: the Democrats and the Whigs.[4] After 1855, the Republican and American (Know-Nothing) parties were the prominent parties in the office. The attitudes of the Democrats and Whigs towards banking can be defined, in part, by their positions on the role of government in the market place.[5] The attitudes that helped define the Republican and American parties towards banking are less clear. Some historians have asserted that they defined themselves based on social issues and less on economic policy.[6]

Democrats

Two main factions vied for control within the Democrat party: the Conservatives and the Jacksonian Hard Currency advocates (also known as the Radicals or Locofocos).[7] Conservative Democrats were willing to support the current form of banking with legislative oversight; many of the Conservative Democrats were bankers themselves. The current system required a group of citizens to petition the legislature in order to receive the right to operate a bank and to receive the special privileges of a banking corporation. As a corporation the bank would be privileged to issue paper currency (bank notes) and the stockholders would receive limited liability. The charters were individually crafted bills voted upon by the legislature and signed into law by the governor.

The populist Jacksonian Hards were critical of the process because it allowed the legislature to grant exclusive privileges to selected individuals. They argued that banking should be available to anyone in the public willing to commit resources to the enterprise. Furthermore, they believed that banking should be based on "hard" (metallic) currency and

not paper currency (bank notes), and that the legislature should not give special privileges such as limited liability or the right to issue paper currency.

Although the Hards gained strength in several legislatures after the 1837 banking crisis, political realities prevented the Hards in the Democratically strong New England states from obtaining their ideal of a lassiez faire system.[8] Consequently, the Hards pursued two reforms, which would gain some support from their Conservative colleagues. One of these reforms focused on limiting the bank note issue.[9] These regulations not only limited note issue, but also reduced the profitability of operating a bank. In addition to regulating operations, the Hards pursued reforms that provided greater access to bank charters to the public. They would either freely approve charter petitions or enact a law that allowed entry without legislative approval. This approach was known as the free banking laws.[10] Some have contended that the free banking approach of the Hards may have reduced the political barriers, but also raised economic barriers.[11] Complying with the provisions of the law made it difficult to compete with a chartered bank.

Whigs

The Whig Party was formed between 1834-1836 by those who opposed Andrew Jackson's more radical anti-government, anti-bank ideology. According to Michael Holt, the Whigs sought ways to enlarge their coalition by drawing in Conservative Democrats who supported "positive legislation to expand credit and the money supply, [and who] promote private investment by giving tariff protection to manufactures and by limited stockholder liability..."[12] For the Whigs, granting exclusive privilege by the legislature was necessary to promote economic growth. As Van Duesen (1973) observed, the Whigs "wanted well-conducted banks, a well-regulated paper currency, and sound cautious fiscal policies." (p348) A "well-regulated" currency did not include free banking type reforms.

Overview of State Parties and Bank Entry

New England's political landscape took the form of a mosaic where five of the six states were dominated by one party (until 1855) with each state taking a slightly different approach to banking; only in one state – Connecticut – no particular party dominated the governor's office. (See Table 1 for a summary of the years a political party held the governor's office.) Two of the states were Democratic strongholds: Maine and New Hampshire. In Maine, the Democrat-lead state appeared to be a de facto free banking state by liberally approving charters.[13] From 1836 to 1859 the state legislature approved 115 charters, 39 of which never went into operations.[14] The New Hampshire Democrat Party attempted to pass a free banking law several times between 1839 and 1844 without success. (Smith, p 218) Since free banking reform was unsuccessful, they pursued policies that restricted note issue. (Cole, p192-193.)

The Whig party dominated Massachusetts, Rhode Island, and Vermont. The cautious, deliberate approach of the Whigs in Massachusetts can be seen in the Joint Standing Committee Report on Banks and Banking (1853) where they outline the criteria for granting a request. The Democrats made little headway in Massachusetts. They were able to capture the office for four terms; in 1840, 1843 and 1851-1852. During their short tenure in the 1850's a free banking law was passed. Rhode Island had a string of Whig

Governors until 1851 when they elected a Democratic Governor. They held the office until 1854 when the Whigs returned to the office. In Vermont, the Whigs held the office expect for one term in 1853-1854. Uncharacteristically, the Whigs passed a free banking law in 1851. With a legislature continuing to issue charters, and with strong opposition to the free banking law by the banking commissioners, few banks entered under the law.[15]

Connecticut was the only state where the Democrats and Whigs held the same number of terms in office. During a Democrat's term, the legislature passed a Free Banking Law in 1852. Two years later when the Whigs ousted the Democrat and the legislature started to issue charters again. They brought an end to free banking when they repealed the law in 1856. Unlike the Vermont experience, Connecticut experienced a large increase of banks after the enactment of the law.

From this review, it appears that in some cases the Democrats were successful in legislating their political ideology by implementing free banking reform or establishing a system that appeared to be de facto free banking. The Whigs, on the other hand, maintained legislative oversight and access to the market. The ideological positions suggest, in the absence of a free banking law, that Whigs would be more willing to grant charters than the Democrats.

The regulatory approach of the Democrats therefore would result in slower rates of growth in bank entry than that seen under the Whigs, unless the Democrats enacted a free banking law or followed an open access approach to entry. In Democrat states that enacted free banking legislation or followed free access, entry rates are expected to grow at a faster rate than those in a Whig state. It appears from a review of the annual net entry rates of the period (See Figure 1) there is no clear evidence that net entry differ by particular party. Democrats had higher rates of net entry than Whig Governors in four of the six states: they were slightly higher in Vermont, and Connecticut, and significantly higher rates in Maine and Rhode Island. The higher rates in Vermont, Connecticut, and Maine could be as a result of Democrats who supported free banking/access reform policies. The Whigs had significantly higher rates in New Hampshire and slightly higher rates in Massachusetts. The difference in New Hampshire could have been due to the hard-line regulatory approach of the ruling Democrats. Although Massachusetts enacted a free banking law, it appears that it did not create greater access than that which entered while the Whigs were in control.

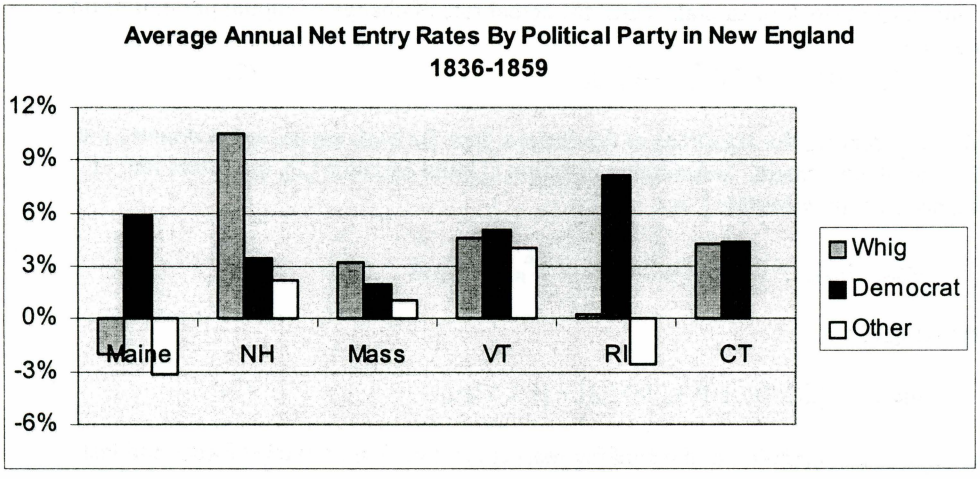
THEORY OF ENTRY RATES AND POLITICAL BARRIERS

Although there appears to be differences in net entry rates within each state due to political ideology, this does not necessarily show whether the political parties were barriers to economic growth within the states or whether they were moved by economic forces from outside the state or. Internal market conditions may have coincided with the party that was elected into office. The evidence in Figure 1 does not help us determine whether regional economic forces influenced the state banking/monetary policy.

Furthermore, net entry does not necessarily indicate the approach a political party may take to increase their bank capital and expand money supply. Some parties may have elected to increase the money supply through enlarging established banks instead of authorizing the establishment of a new bank through a charter. Where there was political

resistance to new banks, legislators could accommodate the market by increasing banking capital of existing banks. The charters issued by New England states would typically stipulate the exact amount of the capital that could be raised by the owners. Most charters would give the owners one year to raise the amount of capital needed. If unsuccessful, the petitioners would have to return to the legislature the next year and request an extension and/or reduction in the minimum amount of capital. Banks holding a charter would also require legislative approval to increase their capital.[16] The reasons for granting charters instead of enlarging the bank were varied, some of which may have been based on the political ideology of the ruling party.[17]

Figure 1.



Since entry of bank capital could take two forms, two models of bank capital in a competitive market are examined. The first model presents the competitive level of total bank capital in the market as developed by Peltzman (1970), Throop (1975) and Dwyer (1981). The second model examines the competitive entry rate of banks in the market as developed by Peltzman (1965).[18] Although these studies have examined the national banking market, they provide the basis for our modeling of capital formation within an antebellum state. The desired equilibrium level of capital stock (C^*_{jt}) is a function of the level of deposits within a state (D_{jt}), the expected return on bank capital (R^e_{jt}), and the level of regional banking activity of neighboring states (RB_{jt}):

$$C^*_{jt} = h(D_{jt}, R^e_{jt}, RB_{jt},) \qquad (1)$$

In a competitive market, we would expect that the level of desired capital would increase with the level of deposits within the state. Depositors view capital as a measure of security and would demand more capital from a bank as deposits increase. As in typical

markets, an increase in expected profitability will lead to an increase the desired level of capital.

Finally, a variable was added to capture the interstate effects of bank entry. New England was the only region where bank notes from different New England States circulated at par. Since the system allowed bank notes to travel and circulate among the states at par, entry within one state could potentially have an effect on another state's monetary system. If out-of-state bank notes are near-perfect substitutes for in-state bank notes, an increase in competition from out-of-state banks could potentially decrease the desired level of bank capital within a state. In New England where the Suffolk system operated, we would expect that out-of-state notes would circulate equally with in-state bank notes.

Entry of capital within a state occurs when the actual stock of capital deviates from the desired stock of capital. Thus, the actual rate of change of capital per unit of time for state j is

$$\ln C_{jt} - \ln C_{jt-1} = \lambda(\ln C^{*}_{jt} - \ln C_{jt-1}), \qquad (2)$$

where $\ln C^{*}_{jt}$ denotes the logarithm of the desired flow for bank capital and λ denotes the coefficient of adjustment. Substituting equation (1) into equation (2), the actual rate of capital accumulation in state j is

$$\ln C_{jt} - \ln C_{jt-1} = \lambda\,[h(\ln D_{jt}, \ln RB_{jt}, \ln R^{e}_{jt}) - \ln C_{jt-1}]. \qquad (3)$$

Rearranging (3),

$$\ln C_{jt} = \lambda\,[h(\ln D_{jt}, \ln RB_{jt}, \ln R^{e}_{jt})] + (1-\lambda)\ln C_{jt-1}. \qquad (3a)$$

Thus, capital accumulation in the banking market is a function of market forces and last period's level of capital.

The desired level of capital also provides the basis for the theory of entry into the market. Peltzmen (1965) has provided a simple model that identifies the variables that would determine bank entry in a competitive market. By definition, bank capital per bank for the jth state in time period t (S_{jt}) is equal to total capital (C_{jt}) divided by the total number of banks (B_{jt}):

$$S_{jt} = C_{jt}/B_{jt}. \qquad (5)$$

The rate of change in the number of banks can be found by differentiating equation (5) with respect to time,

$$\frac{1}{B_{jt-1}}\frac{dB_j}{dt} = \frac{1}{C_{jt-1}}\frac{dC_j}{dt} - \frac{1}{S_{jt-1}}\frac{dS_j}{dt} \qquad (6)$$

By definition, the rate of change in the number of banks is equal to the rate of net entry (NER):

$$\frac{1}{B_{jt-1}}\frac{dB_j}{dt} = NER_{jt} = E_{jt} - M_{jt} - X_{jt}, \qquad (7)$$

where E is the entry rate, M is the merger rate, and X is the exit rate.[19] Substituting equation (6) into (7) we have

$$NER_{jt} = \frac{1}{dC_{jt-1}} \frac{dC_j}{dt} - \frac{1}{S_{jt-1}} \frac{dS_j}{dt} \quad (8)$$

Thus, equation (8) states that the net entry rate in the market will increase with the increased rate of total capital accumulation and will decease with the percentage increase in average capital size.

From our capital accumulation model above, substituting equation (3) into (7), we find that net entry rate is equal to

$$NER_{jt} = \lambda [h(\ln D_{jt}, \ln R^{e}_{jt}, \ln RB_{jt})] - \ln C_{jt-1}] - \frac{1}{S_{jt-1}} dS_j \quad (8)$$

Thus, the competitive model predicts that net entry is a positive function of deposits, and regional banking activity, and inversely related to the rate of return on alternative investments, lagged capital, and the growth in capital per bank.

The competitive model may have been representative of entry in "free banking states", but not necessarily in the chartering states. In a chartering system where the Governor is the gatekeeper of entry, the political ideology of the governor may have created a barrier to entry. As noted above, in some cases, a state may have become more open or closed as a new political party gained the governor's seat. Furthermore, if the party was slow to issue charters the monetary policies of neighboring states may influence entry decisions. If legislators are slow in providing the desired level of capital, in-state bank activity could increase as neighboring state banking activity increases. Legislators may listen to "good reason" from petitioners requesting additional capital or incorporating a new bank if neighboring state banks are intruding into their state. Such were the arguments made by Massachusetts's petitioners.[20] Thus, we would expect a positive relationship between in-state banking capital and neighboring banking activity if the state did not provide sufficient capital to meet the in-state needs and was responsive to the in-state petitioners.

Finally, chartering states may have signaled a shifted in banking policy by enacting new legislation. Several New England states enacted a free banking law that allowed entry without legislative approval; they also continued to issue charters. In these dual banking states, legislators - no matter what their party affiliation - may have signaled the market that they would be "more" willing to issue charters; thus, lowering a political barrier.[21]

THE EVIDENCE ON ENTRY RATES 1836-1859

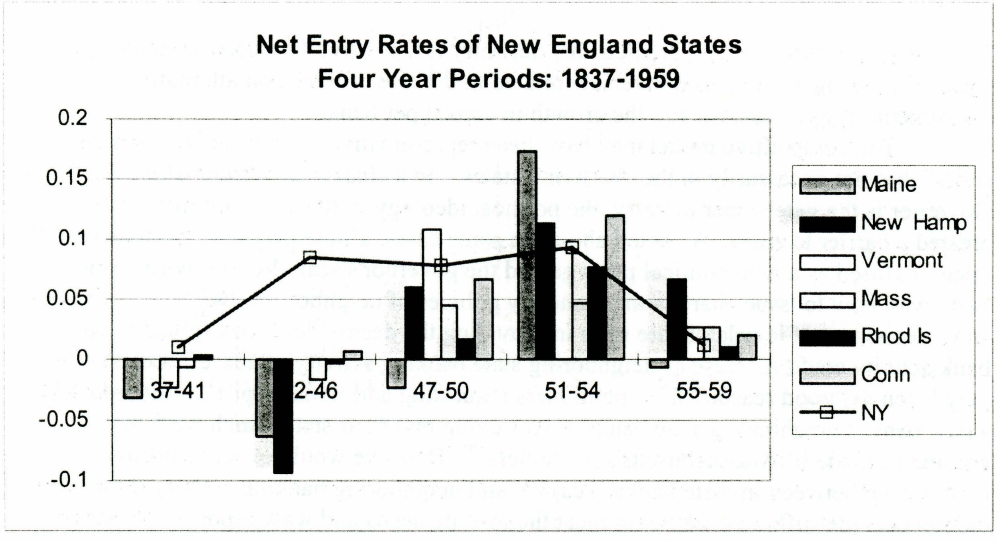
Overview

Entry data were compiled from various state bank condition reports and the 1876 Report of the Comptroller of Currency. From these reports the number of banks and bank balance sheet information was collected for the period 1836 to 1859.[22] From the Congressional Quarterly, the party of the Governor was determined. Three major parties

were at some point in the states' governor's seat: Democrat, Whig, and Republican parties.[23]

We first examine the averages of net entry rates for four-year periods.[24] If markets were completely independent and manipulated by political ideology we would expect a random display of entry rates across states. The data, however, shows a strong correlation of entry among the New England States. (See Figure 2.) As a benchmark, the net entry of New York is given as well. (New York maintained a free banking system from 1838 to the Civil War.) In Figure 2, it appears that the New England States net entry patterns were markedly different than New York during the early 1840's, but moved with New York in 1846 and thereafter.

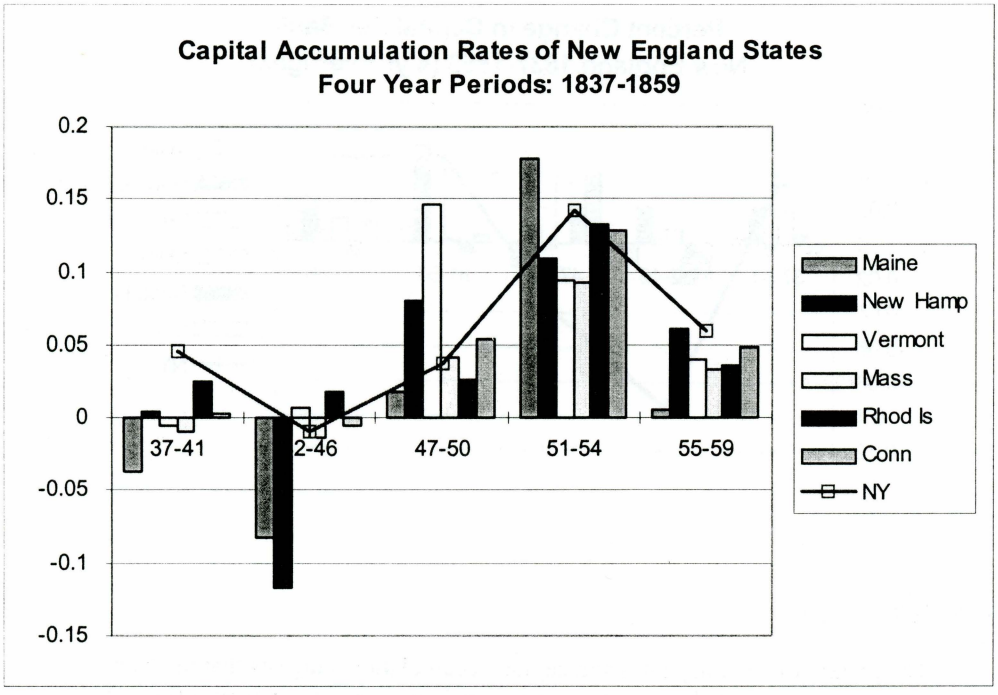
Figure 2



The period between 1837 and 1841 showed only one New England State – RI - with an increase in entry activity. While New England showed a decline, New York showed a positive growth in the number of banks during the early years of free banking. Over the next four year period, entry activity continued on average to decline in most New England States, while NY continued to showed a strong increase and CT showed only a slight increase in entry. In general, we find recovery in the region with positive growth between 1847 and 1854. Only Maine showed a decline in the first period, but appeared to have recovered strongly between 1851-54. During the latter part of the decade, all states showed a slow downturn in net entry rates with Maine showing a decline in the total number of banks. This movement suggests an integrated market, free from political ideology.

In Figure 3, the rate of capital accumulation in New England and New York for four- year periods is presented.

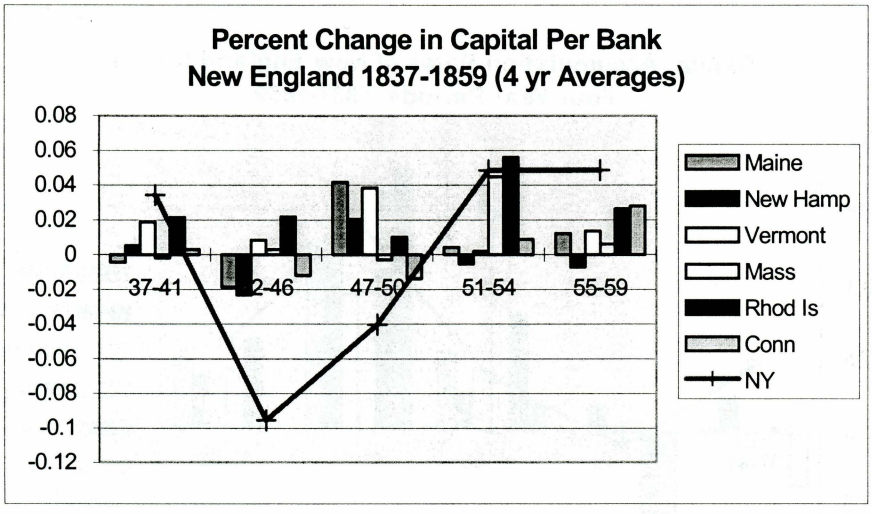
Figure 3.



The pattern of capital accumulation rates in New England is very similar to that of the net entry, and it appears that New England followed closely the rate of capital accumulation of New York. With growth rates of new entrants approximately equal to the growth in capital, this would suggest that the bank entry policies of the New England States were primarily conducted through the issuance of charters and not through the enlargement of existing banks. While in NY with entry rates higher than rates of capital accumulation, it appears that banking became more accessible, but smaller than their New England counterpart.

There is some support for this observation. In Figure 4, growth in capital per bank was, in general, very low throughout the period. In very few cases do we find four-year growth rates above 2%, and only one state – Rhode Island - showed growth in capital per bank at least 1% for each period.

Figure 4



State by State Analysis

The pattern of net entry rates and capital accumulation suggests that the New England market was integrated and that the state legislatures may have been influenced by economic forces rather than political ideology. To rigorously test this assertion, we test the following general models for each state: [25]

$NE_{jt} = \alpha_0 + \alpha_1 \ln D^{sa}\, jt + \alpha_2 \ln R_{t-1} + \alpha_3 \ln RBN_{jt-1} + \alpha_4 \ln C_{jt-1} + \alpha_5 S_{jt} + \alpha_6 Dem_{jt} + \alpha_7 Rep_{jt} + \alpha_8 FBL_{jt} + \eta_{jt}$, and

$\ln C_{jt} = \beta_0 + \beta_1 \ln D^{sa}{}_{jt} + \beta_2 \ln R_{t-1} + \beta_3 \ln RBN_{jt-1} + \beta_4 \ln C_{jt-1} + \beta_6 Dem_{jt} + \beta_7 Rep_{jt} + \beta_8 FBL_{jt} + \varepsilon_{jt}$.

The measure for bank deposits (D^{sa}) for state j in time period t is the total seasonally-adjusted bank credits in the state which is equal to bank deposits plus bank notes.[26] A proxy for the expected rate of return in time period t (R^e_t) is the commercial paper rate in the Boston financial market lagged one period.[27] A proxy for regional bank activity (RBN_{jt-1}) is the number of bank notes issued by neighboring states lagged one period.[28] Due to the chartering process capital formation would take at most a year to respond to regional activity. S_{jt} is the growth in assets per bank. Assets per bank measures both the impact of capital per bank as well as economies of scale effects on net entry. It is expected that bank deposits, and the expected return, will be positively related to both net entry and capital accumulation. The sign on regional banking activity will depend on the degree of political barriers. Net entry is expected to be negatively related to the growth in assets per bank. The coefficient of adjustments of capital to desired levels of capital is

denoted by the coefficients α_4 and β_4, where α_4 is expected to be negative and β_4 is expected to be positive. Two dummy variables representing the political party in the governor's office were created: Democrat and Republican. (The intercept would therefore represent influence of the Whig Party.) Each New England State held annual gubernatorial elections. Due to the legislative process, we assume that net entry will be impacted the year after the term of office. The coefficient is expected to be negative for Democrats and uncertain for Republicans. Finally, a dummy variable was also created taking on a value of one for the years that a free banking law was in effect in that state.

In Table 2, the results of the regression for the New England States and New York are given. New York is given as the benchmark for a competitive system and does not include any of the dummy variables. In general, it appears that the results support the basic model. The coefficients that are significant have the expected signs. Commercial paper rates were positive and significant in determining the net entry rates in two states (Massachusetts and Connecticut); although commercial paper rates did not impact New York net entry rates. The use of the Boston commercial paper rates may not have reflected the expected profits in the New York Market. In most of the state models the level of deposits and the percentage change in assets per bank have the expected sign and are statistically significant.

The impact of regional activity on monetary policy of the states yielded mixed results. Five of the seven states had negative coefficients with only three of the coefficients being statistically significant: Maine, Connecticut, and New York. In Massachusetts, net entry rates increased when regional notes increased. The positive coefficient implies that the Massachusetts legislature was consistently responding to regional growth and was not accommodating the state banking needs. [29]

Net entry rates, in most states, were not influenced by political ideology. In only two states do we find party affiliation of the Governor having a significant impact on net entry. When the Democrats held the governor's office in Massachusetts and Rhode Island, we find net entry rates influenced. In Massachusetts net entry declined while in Rhode Island net entry increased.

The decline in Massachusetts could be linked to the enactment of the Free Banking Law. In 1851 and 1852, a Democrat held the governor's office and was able to push through a free banking law. At the same time, the legislature approved an increase of bank capital over $5 million - $1.25 million in capital from seven new charters and $3.9 million to existing banks; an increase of 13%. In 1852, no new banks entered under the new law nor were chartered by the legislature. The return of a Whig governor prompted the legislature to evaluate the effectiveness of the free banking law since there was little interest in establishing a free bank, but significant interest in establishing chartered banks. The majority report recommended the repeal of the law and the return to the issuance of charters.[30] Even though the law remained on the books, the legislature appeared to shifted its entry policy and started to issue more charters - as noted by the positive coefficient on the free banking law coefficient which was significant at the 86% confidence level.

Rhode Island also found itself with a Democrat Governor in 1851. Between 1836 and 1851, only 4 charters were issued by the legislature. The Democrat platform of greater access seemed to have been implemented as evidenced by the fourteen new banks that entered the market during the Democrats' three years in office. Rhode Island was also the only state where net entry was significantly changed during the period when the

Republican Party was in office. The observed decline may have been a coincidence. The first Republican took office in 1856, the year before the Panic of 1857. Many of the charters issued in the 1850's were issued to stockholders of manufacturing firms whose distinct purpose was to take over corporate obligations.[31] The fall of the firms from the panic lead to the failure of 15 banks - over 15% of the banks. Although new charters were issued after the panic, they never reached their pre-panic level.

Thus, it appears that most of the chartering states managed entry such that neighboring state activity did not impact in-state profitability nor did it stir residents to increase petitions for bank capital. For those states that were relatively free, neighboring state's note issue did impact the profitability of in-state banks; an increase in bank notes form neighboring states lowered net entry rates. Political ideology seems to be a significant influence in two states, thus creating barriers to entry. Although three states signaled shifts in entry policy with the enactment of a free banking law, there appears to be no sustainable change in entry policy.

Table 3 presents the results of the capital accumulation model. Like the net entry model the coefficients of the basic competitive model have the expected signs, many of which are statistically significant. We do, however, find several states consistently changing the level of capital in response to neighboring state bank activity. Massachusetts, Rhode Island and Connecticut all showed a positive responsive to changes in bank notes issue by neighboring states. Massachusetts was the only state that increased both the number of banks and the rate of capital accumulation when regional notes increased. This result is not surprising since Massachusetts was the home of the Suffolk Bank, and would be acutely aware of the bank note flows of the region. The Rhode Island result suggests that Rhode Island may have had a preference for increasing capital instead of issuing charters regardless of who held the governor's office. Connecticut's results may be a result of it's proximity to New York City and the reputation of the Suffolk Banking System. As New York's notes entered Connecticut, petitioners sought and won approval for new capital from the legislature. Thus, high periods of regional bank notes encouraged increased demand for Connecticut bank capital.

It appears that political ideology did not present a barrier to capital accumulation. Only in Maine while the Republicans were in office was there a significant shift in capital accumulation rates. During their brief tenure, capital declined 16% on average. In those states where political barriers limited net entry, we find that they did not create a barrier to the inflow of capital. This suggests that it may have been more politically acceptable to limit entry and to increase capital levels of existing banks.

Finally, we find that the enactment of the free bank law resulted in a shift in bank policy in Massachusetts. After the law was enacted there was a significant increase in capital accumulation holding all other factors constant - including political ideology. Thus, when the Democrats left the office in 1852, the Whigs and the American Party continued to increase the capital at a rate greater than prior to the enactment.

SUMMARY

During the antebellum period, state legislatures of New England, through their control of bank charters and bank capital, were effectively controlling the monetary policy of the state. The banking market within the region was also highly integrated with the

establishment of the Suffolk Bank which allowed bank notes (currency) to exchanged at face value. Under this system, we could observe how economic forces through the monetary policies of neighboring states influenced the political/monetary policies of a particular state. The options facing legislators were either increasing the rate of banking capital, increasing the rate of new competitors, or both. We find that that legislative process imposed some barriers in certain states.

The data indicates that three of the states - Mass., R.I., CT. - responded to the monetary policies of neighboring states by either increasing the number of banks or capital when regional bank notes increased. These results suggest that the legislators of these states were limiting entry and responded to the demands of the petitioners regardless of the party that held the governor's office.

The notion that political ideology would impact the banking policies of the period is supported in two of the three states - Mass. and R.I.- that responded to regional bank notes. In these two states the political influence was strongly associated with the issue of bank charters, not with the adjustment in capital. A third state - Maine - showed a decline in capital when the Republicans held office, but no change in the issuance of bank charters.

Finally, the public sentiment may have been poised for the shift in bank policy as a number of states - Connecticut, Massachusetts, and Vermont - were willing to enact free banking laws.[32] Only in Massachusetts do we find a significant increase in bank capital after the free banking law.

The result raises new questions about the impact of the legislative process on the banking market. Since the legislatures screened petitioners, and in some cases limited the amount of capital in the market, did the legislative process also distort the allocation of bank capital? Were the legislators willing to accept the petitioner's location requests or were there certain regions that benefited from those that were connected with the political leadership? The legislative process, though appearing to be free, may have been allocatively inefficient.

ENDNOTES

1 Richard Sylla (1985) reviews the development of antebellum incorporation law and makes a distinction between free banking and free bank incorporation.

2 Douglas North (1990) rightly contends that political rules and institutions leads to economic outcomes, but the feedback of economic outcomes leads to a modification of the political rule. (P48).

3 Preliminary evidence on interstate effects was found by Economopoulos and O'Neill (1995). They showed that states that issued charters increased the entry rate of banks at the same time when a number of states enacted free banking laws. They were unable to determine whether there was any direct interstate effect of the free banking laws.

4 An examination of the party in the governor's office and majority party in legislature is beyond the scope of this study. The governor represents the gatekeeper of all legislation and should provide a good proxy for examining political barriers.

5 In The Market Revolution in American (1996) Michael Holt makes the assertion that "most historians" agree to this point. He cites empirical evidence that after the depression of 1837, the Whigs and Democrats held sharply divergent position on the role of government in the market place.(p.224-229)

6 Holt(1996) presents Eric Foner's argument that the Republican and American parties were the coalition of ex-Democrats and ex-Whigs who rallied around key social issues. Leaders of these parties avoided positions on economic issues. (pp. 232-233)

7 This review is a summary of following works: Lamoreaux (1994) pages 35-51, Cole (1970) pages 185-215, and Formisano (1983) pp 268-301.

8 In the Whig strong states, they were able to gain some leverage to accomplish some of their programs.

9 Lamoreaux (p.42) explains this apparent inconsistency. If they could not eliminate the special privilege and return the industry to private enterprise, than the institution of banking rests within the public domain and they would take on the role as responsible managers.

10 Some states during this period enacted free banking legislation and continued to issue charters; thus, maintaining a Dual Banking System. Three New England states enacted free banking laws: Vermont (1851) , Massachusetts (1851), and Connecticut (1852). There were few free banks entrants in the first two states, while there were several entrants in Connecticut. In these states most of the banks that entered chose to entered under the charter system.

11 Ng (1998) contends that the free banking laws may have lowered political barriers, but raised economic barriers.

12 Holt pp.235.

13 In 1836, a Maine Joint Standing Committee issued a report on the granting bank charters. The members contended that "banks now incorporated enjoy a monopoly of the privilege of supplying currency of the state" and that "the amount of bills (bank notes) would not be affected by the increase number of banks." Their reasoning for granting charters freely: "... that in every country, the currency will accommodate itself very nearly to the wants of the community..." (pp1-3) This economic principle of monetary policy (free access) appeared to hold through the period.

14 See Chadbourne (1936) pp 182-184.

15 A brief sketch of Vermont's first free bank and their difficulties is given by Harper (1936) pages 32-34.

16 Banks could avoid the legislature and increase capital through retained earnings. Connecticut, Maine, Massachusetts, and Rhode Island listed retain earnings on their condition reports. These "surpluses" where designated for the payment of dividends. At times the distribution of dividends exceeded the level of retained earnings. (See the 1851 Massachusetts Bank Commissioner's Report, p 94 and Lamoreaux p.73) It does not appear that retained earnings was used as a source of capital during this period for two reasons. First, Attack and Rousseau (1999, p. 156) found that earnings were distributed in order to maintain stock prices near par value and to signal to the market a healthy institution. Second, the use of

retained earnings did not qualify as capital and would provide limited benefits to the bank. Authorized capital was the only basis for bank-note circulation.

17 Some economists might argue that political ideologies are strongly influenced by economic incentives. For instance, Sylla, Legler and Wallace (1987) found that during this period many states relied on charter banks as a significant source of state revenues. Thus, issuance of state charters may be linked to the demand for new revenues.

18 These models applied the Friedman (1962) model of capital formation over time.

19 During this period there was no branch banking or mergers in New England.

20 Senate Documents, Massachusetts, No 85, March, 1853, p.8

21 Ng (1988) has argued that the free banking laws may have been more restrictive and less profitable to operate. Forcing a petitioner to choose the free banking route would only result in negative political value for the legislator.

22 In some cases, banks that were operating did not submit a report. When non-reporting banks were found adjustments were made to the total number of banks operating, total bank capital, deposits, and bank notes. It was assumed that the bank's capital equaled last period's capital stock and that deposits and bank notes were issued at a rate equal to the industry averages of the deposit-capital, and bank note-capital ratios.

23 A split in the Democrat party brought about the rise of the Republican Party. They were first elected to office in Maine in 1854 and in the other New England States between 1855 and 1857. The American (Know-Nothing) party captured the governor's office in three states for no more than 3 years. They were grouped with the Republican party since the northern branch of the American Party joined the Republican party in 1857.

24 During this period the governors were elected annually. A four-year period was selected for two reasons. First, it allows for entry patterns to be established since it took about 9 months to a year for a bank to complete the requirements before operating. Second, the four-year pattern also coincides closely with two key downturns during the period: 1837 and 1857.

25 Given the many differences in banking regulations, coefficients are likely to be different.

26 Since deposits varied throughout the year and the condition reports were issued at different months of the year, deposits were seasonally adjusted.

27 MacCauley's(1938) work provides data on commercial paper rate on a monthly basis from 1831 to 1860. The commercial paper rate for the month of the condition report was used.

28 Only contiguous states are considered "neighboring states".

29 This result runs counter to the conventional view that Massachusetts was a de facto competitive market. (See Dowd (1993, p.168-169)

30 Commonwealth of Massachusetts, House Document, No. 33, January 22, 1853, pp. 1-15.

31 See Edward Field , State of Rhode Island and Providence Plantations at the End of the Century: A History, Boston: Mason Publishing, Vol. 3, 1902, p 308.

32 In 1846 New Hampshire enacted a general incorporation law, which allowed incorporation as a general right and not as a special privilege. One historian

observed that the New Hampshire "legislature responded promptly to the new laws and to the demands of industrialists. (Cole, 1970, p.212)

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Table 1.
The Years a Political Party Held the Governor's Office
1836 to 1859

State	Democrat	Whig	Republican	American
Connecticut	1836 - 1838	1838 - 1842	1857 – 1859	1855 – 1857
(May)	1842 - 1844	1844 - 1846		
	1846 - 1847	1847 - 1850		
	1850 - 1854	1854 – 1855		
# of Terms	10	10	2	2
Maine	1836 – 1837	1838	1855	
(January)	1839 - 1840	1841	1857 – 1859	
	1842 - 1852	1853		
	1856			
# of Terms	17	3	4	
Massachusetts	1840	1836 - 1839	1858 – 1859	1855 – 1857
(January)	1843	1841 - 1842		
	1851 – 1852	1843 - 1849		
		1853 – 1854		
# of Terms	4	15	2	3
New	1836 – 1846	1846 - 1847	1857 – 1859	1855 – 1857
Hampshire	1847 – 1855			
(June)				
# of Terms	17	1	3	2
Rhode Island	1851 – 1854	1836 - 1851	1856 – 1859	
(May)		1854 – 1856		
# of Terms	3	17	4	
Vermont	1853 – 1854	1836 – 1853	1855 – 1859	
(October)		1854 – 1855		
# of Terms	1	18	5	

Note: Governors were elected annually. ( ) Month in which Governor entered office.Source: Congressional Quarterly, Guide to U.S. Elections, 3rd edition, 1994.

Table 2.
Individual States Net Entry Rate Model New England 1836-1859

	Maine	N.H.	Mass	Vermont	R.I.	Conn	NY
Intercept	0.89 (0.91)	-0.579 (-0.92)	1.70 (1.50)	-0.361 (-0.56)	-0.875 (-3.26)*	-0.152 (-0.35)	0.884 (1.67)
Lagged C.P.R	0.047 (0.93)	0.009 (0.20)	0.053 (3.29)*	-0.007 (-0.20)	0.009 (0.69)	0.059 (2.64)**	0.032 (0.84)
Deposits (sa)	0.640 (5.28)*	0.381 (2.88)**	0.055 (1.26)	0.234 (3.83)*	0.045 (1.61)	0.212 (4.41)*	0.286 (3.45)*
Lagged Capital	-0.297 (-3.10)*	-0.182 (-2.29)**	-0.262 (-2.06)**	-0.117 (-1.11)	0.082 (1.58)	-0.178 (-2.70)**	-0.188 (-2.01)***
% Δ Assets per Bank	-0.698 (-3.72)*	-0.494 (-2.70)**	-0.038 (-0.30)	-0.261 (-2.75)**	-0.173 (-2.89)**	-0.450 (-3.93)*	-0.412 (-2.23)**
Lagged Reg Bank Notes	-0.380 (-2.99)*	-0.083 (-0.84)	0.044 (1.97)***	-0.048 (-1.01)	-0.027 (-1.73)	0.011 (0.28)	-0.223 (-2.71)**
Democrat	0.015 (0.25)	0.050 (-0.55)	-0.043 (-1.95)***	0.000 (0.00)	0.067 (4.39)*	-0.034 (-1.68)	
Republican	-0.100 (-1.38)	-.118 (-0.92)	0.016 (0.43)	0.012 (0.20)	-0.103 (-4.76)*	-0.021 (-0.48)	
Free Bank Law	NA	NA	0.064 (1.57)	-0.062 (-0.84)	NA	0.034 (0.97)	
Adj R^2	.71	.57	.61	.39	.82	.60	.44
D.W.	2.56	1.76	2.12	1.96	1.62	2.70	1.49

( ) are t-statistics. *,**,*** denotes significance at the 1%, 5%, 10% levels.

Table 3: Individual States Capital Accumulation Model
New England 1836-1859

	Maine	N.H.	Mass	Vermont	R.I.	Conn	NY
Intercept	-1.56 (-1.62)	-1.36 (-2.33)	2.14 (1.57)	-0.91 (-1.34)	0.762 (0.75)	-0.656 (-1.72)	-.039 (0.07)
Lagged C.P.R	0.025 (0.41)	0.110 (2.47)**	0.037 (1.92)***	0.057 (1.58)	0.066 (1.20)	0.034 (1.78)***	0.023 (0.57)
Deposits (sa)	0.222 (1.86)*	0.145 (1.11)	0.029 (0.74)	0.162 (2.80)**	0.028 (0.26)	0.066 (2.30)**	0.130 (1.90)***
Lagged Capital	0.912 (9.70)*	0.916 (12.16)*	0.720 (5.76)*	0.996 (8.98)*	0.672 (3.52)*	0.889 (15.44)*	0.833 (8.90)*
Lagged Reg Bank Notes	0.048 (0.38)	0.080 (0.81)	0.046 (2.17)**	-0.034 (-0.66)	0.200 (3.16)*	0.102 (3.46)*	0.040 (0.53)
Democrat	-0.004 (0.06)	-0.094 (-0.98)	-0.036 (-1.68)	0.024 (0.33)	0.073 (1.19)	-0.008 (-0.46)	
Republican	-0.164 (-1.95)***	-0.140 (-1.06)	-0.032 (-0.71)	-0.033 (-0.53)	0.024 (0.28)	-0.004 (-0.10)	
Free Bank Law	NA	NA	0.148 (3.04)*	-0.112 (-1.44)	NA	0.033 (1.06)	
Adj R^2	.96	.97	.99	.99	.95	.99	.96
AR(1) T-Stat	1.04	-0.50	1.68	0.52	-0.16	0.49	0.05

( ) are t-statistics. *,**,*** denotes significance at the 1%, 5%, 10% levels.